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FOR DEPUTY ASSISTANT SECRETARY GRUNWALD

FOLLOWING REPEAT MEXICO 11253 SENT ACTION SECSTATE 01 SEP 76

QUOTE UNCLAS MEXICO 11253

E. O. 11652: N/A
TAGS: EFIN, ETRD, MX
SUBJECT: PRESIDENT ECHEVERRIA'S COMMENTS ON DEVALUATION IN HIS
STATE OF THE UNION SPEECH

1. IN HIS SIXTH AND FINAL STATE OF THE UNION MESSAGE
(INFORME) ON SEPTEMBER 1. PRESIDENT ECHEVERRIA
DEVOTED CONSIDERABLE TIME TO THE FLOATING(IMPLICIT
DEVALUATION) OF THE MEXICAN PESO WHICH HAD BEEN ANNOUNCED
THE EVENING BEFORE. THE FOLLOWING IS A SUMMARY OF HIS
COMMENTS:

2. IN THE BEGINNING OF THE DECADE MEXICO HAD AN URGENT NEED
TO FINANCE PUBLIC INVESTMENT IN BASIC SECTORS OF THE ECONOMY. TO
PRESERVE CONFIDENCE IN THIS FINANCIAL AND ECONOMIC POLICY IT WAS
ESSENTIAL TO MAINTAIN A STABLE EXCHANGE RATE BETWEEN THE MEXICAN
PESO AND THE U.S. DOLLAR. HOWEVER, IN THE EARLY 1970'S THE GREATEST
MONETARY, TRADE AND FINANCIAL CRISIS THE WORLD HAS EXPERIENCED IN
RECENT DECADES AROSE. VALUE OF CURRENCIES FLUCTUATED CONSIDERABLY,
AFFECTING TRADE AND PRICES THROUGHOUT THE WORLD,
AND INFLATION RATES REACHED VALUES UNKNOWN FOR 30 YEARS.

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ECONOMIC ACTIVITY DROPPED THROUGHOUT THE WORLD AND COUNTRIES

IN THE PROCESS OF ECONOMIC DEVELOPMENT SAW THEIR EXPORT MARKETS REDUCED AND PRICES OF IMPORTS RISE. HENCE MEXICO'S DEFICIT ON CURRENT ACCOUNT ROSE FROM 1.175 BILLION DOLLARS IN 1973 TO 3.643 BILLION DOLLARS IN 1975. DESPITE WORLDWIDE ADVERSITY, MEXICO DECIDED TO PRESS ON WITH ITS DEVELOPMENT PLANS. BUT MAJOR PROBLEMS REMAIN TO BE SOLVED; MEXICO MUST RESTRUCTURE ITS ECONOMY IN LIGHT OF THE CHANGING WORLD SITUATION.

3. PRESIDENT ECHEVERRIA THEN REVIEWED THE VARIOUS MEASURES HIS ADMINISTRATION HAD TAKEN TO REDUCE MEXICO'S DETERIORATING BALANCE OF PAYMENTS. HE CONCLUDED THAT THEY HAD NOT BEEN EFFECTIVE ENOUGH AND THAT THE CURRENT RATE OF EXCHANGE OF THE MEXICAN PESO WAS NOT CONDUCIVE TO RESTORING A HEALTHY BALANCE OF PAYMENTS. "OBTAINING FOREIGN FINANCING TO SUPPORT THE DOMESTIC PRODUCTIVE PLANT AND IMPROVE OUR EFFICIENCY IS JUSTIFIABLE. OBTAINING FOREIGN CREDIT TO FINANCE PERMANENT DEFICITS IN CONSUMER GOODS OR RAW MATERIALS IS LESS JUSTIFIABLE. BUT ALLOWING EXCESSIVE INCREASES IN THE FOREIGN PUBLIC DEBT OR UTILIZING THE BANK OF MEXICO'S BASIC GOLD AND CURRENCY RESERVES TO FINANCE SPECULATIVE FLIGHTS OF CAPITAL ABROAD IS ABSOLUTELY UNACCEPTABLE." THE OLD RATE OF EXCHANGE NO LONGER REFLECTED THE REALTION BETWEEN MEXICAN PRODUCTION COSTS AND COSTS IN OTHER COUNTRIES. HOWEVER A NEW FIXED RATE WOULD NOT BE IMMEDIATELY ESTABLISHED BECAUSE SERIOUS DISTORTIONS IN THE EXCHANGE RATES OF MAJOR CURRENCIES STILL EXIST. "THE NEW RATE OF EXCHANGE MUST BE DETERMINED UNDER CONDITIONS OF FREE CONVERTIBILITY, AND MUST FUNDAMENTALLY BE A RESPONSE TO THE REAL ECONOMIC FORCES OF THE MARKET THAT ARE SHAPED BY THE CURRENT NATIONAL AND INTERNATIONAL SITUATION. THE RATE OF EXCHANGE MUST BE FLEXIBLE FOR A TIME SO THAT IT CAN REACH THE BEST LEVEL TO ENABLE US TO CORRECT THE DEFICIT IN OUR BALANCE OF PAYMENTS AND DEAL WITH SPECULATIVE FLIGHTS OF CAPITAL WITHOUT MAKING USELESS SACRIFICES OF OUR COUNTRY'S GOLD, SILVER AND CURRENCY RESERVES."

4. THE FLUCTUATION OF THE EXCHANGE RATE WILL BE REGULATED TO AVOID EXCESSIVE AND ERRATIC FLUCTUATIONS WHICH DO NOT REFLECT THE TRUE ECONOMIC POSITION OF THE COUNTRY. TO UNCLASSIFIED

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HANDLE THIS THE BANK OF MEXICO HAS FOREIGN EXCHANGE RESERVES OF 1.381 BILLION DOLLARS PLUS FULL DRAWING RIGHTS ON THE IMF AND U.S. TREASURY SWAPS OF 1.046 BILLION DOLLARS. FURTHERMORE, IMMEDIATE STEPS WILL BE TAKEN TO INCREASE THESE RESOURCES. "CONTROLLED FLOATING WILL BE ACCOMPANIED BY THE UNCONDITIONAL MAINTENANCE OF THE TRADITIONALLY FREE CONVERTIBILITY OF THE MEXICAN PESO INTO ANY OTHER CURRENCY AND THE UNRESTRICTED TRANSFER OF

MONEY AND CAPITAL". TO ENSURE MAXIMUM EFFECT FROM THE DEVALUATION, ECONOMIC AND FINANCIAL STRATEGY WILL BE DEVELOPED IN LONG AND SHORT TERM PROGRAMS.

5. THE RISE IN DOMESTIC PRICES MUST BE KEPT SUBSTANTIALLY LOWER THAN THE ADJUSTMENT OF THE EXCHANGE RATE. THIS WILL BE DONE WITH: (A) AN INITIAL TAX ON EXPORTS IN THE FORM OF A SURCHARGE; (B) CANCELLATION OF REIMBURSEMENT FOR TAXES PAID ON EXPORTS; (C) THE ELIMINATION OF UNNECESSARY CONTROLS AND REDUCTION OF TARIFFS ON IMPORTS OF RAW MATERIALS AND NECESSARY SPARE PARTS.

6. THE PURCHASING POWER OF THE POPULACE MUST BE PROTECTED BY: (A) SALARIES AND PENSIONS OF CIVIL SERVANTS WILL BE ADJUSTED TO RESTORE LOST PURCHASING POWER; (B) SIMILAR ADJUSTMENTS WILL BE EXTENDED AS FAR AS POSSIBLE TO OTHER WORKERS; (C) STRICT CONTROLS WILL BE MAINTAINED OVER DOMESTIC PRICES OF ESSENTIAL CONSUMER GOODS; (D) NO CHANGE IN THE PRICE OF FOODSTUFFS HANDLED BY CONASUPO (THE GOVERNMENT WHOLESALE AND RETAIL FOOD CONCERN); (E) NO INCREASE IN FINANCE CHARGES ON SMALL LOANS BUT INCREASED INTEREST RATES FOR SMALL SAVERS; (F) HOARDING AND SPECULATIVE MARKET BEHAVIOR WILL BE COMBATED.

7. A BILL WILL BE SUBMITTED ESTABLISHING SPECIAL TAXES ON EXCESSIVE PROFITS RESULTING FROM MODIFIED EXCHANGE RATE.

8. SPECIAL TAX TREATMENT WILL BE EXTENDED TO PRIVATE ENTERPRISE AND SUBSIDIES TO PUBLIC ENTERPRISE IN CASES WHERE THESE ARE SERIOUSLY AFFECTED BY CHANGES IN THE EXCHANGE RATE.

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9. THE PUBLIC SECTOR WILL HAVE TO REDUCE ITS PRESENT GAP BETWEEN INCOME AND EXPENDITURES, BUT WITHOUT LOWERING PUBLIC INVESTMENT IN INFRASTRUCTURE, PRODUCTIVE ACTIVITY, AND SOCIAL ASSISTANCE.

10. THE GROWTH OF CREDIT WILL BE REGULATED BY THE BANK OF MEXICO, BOTH TO THE PRIVATE SECTOR AND THE PUBLIC SECTOR; THE LATTER BY MEANS OF QUARTERLY FINANCING STRICTLY CORRELATED TO THE AUTHORIZED BUDGET. THE SAME CRITERIA WILL BE APPLIED TO THE HANDLING OF THE PUBLIC FOREIGN DEBT.

10. PRESIDENT ECHEVERRIA ENDED THE PART OF HIS SPEECH ON DEVALUATION WITH A CALL TO ALL BRANCHES OF THE ECONOMY -- MANAGEMENT, LABOR, AND PUBLIC -- NOT TO TRY TO TAKE ADVANTAGE

OF THE SITUATION TO INCREASE THEIR SHARE OF THE SOCIAL
PRODUCT. OTHERWISE, THE COUNTRY AND ITS NON-SALARIED AND FIXED
INCOME SECTORS WOULD BE SERIOUSLY INJURED. HE SAID THE COUNTRY
NEEDS THE SUPPORT AND COOPERATION OF ALL SECTORS TO
ACHIEVE ITS AIMS. IT STILL FACES DIFFICULT SITUATIONS
AND SERIOUS SOCIAL CONTRADICTIONS PERSIST BUT THESE
PROBLEMS WOULD HAVE BECOME MORE ACUTE HAD THE ADMINIS-
TRATION FAILED TO TAKE THE DECISIONS IT DID. THIS IMPORTANT
ECONOMIC POLICY WOULD INCREASE THE COMPETITIVENESS OF
MEXICAN EXPORTS AND PRODUCTION OF GOODS AND SERVICES AT
AN OPPORTUNE MOMENT, JUST BEFORE THE FORTHCOMING CHANGE
IN ADMINISTRATIONS. "THIS WILL PERMIT THE REACTIVATION
OF THE ECONOMY AND INCREASE JOBS, FOOD SUPPLIES, HOUSING,
CLOTHING, EDUCATION, SOCIAL SECURITY."
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